Pizza Time Theatre, Inc. 1981 Annual Report

Company Profile

Pizza Time Theatre, Inc. operates and franchises Chuck E. Cheese's Pizza Time Theatre family-oriented restaurant and entertainment centers. The concept for these centers combines three elements: a quality pizza restaurant, video games and other amusements, and musical entertainment provided by the Pizza Time Players – computer-controlled robot characters.

These original robot characters, and the system of control computers and software which synchronizes their voices and movements to dialogue and songs, are created and manufactured by the Company for use in all Pizza Time Theatres. This entertainment system is trademarked as "Cyberamics."

The Pizza Time concept was developed by Nolan K. Bushnell and Joseph F. Keenan, founders of the Company. The first center opened in 1977, and in June 1978 the Company acquired all rights to the concept and the single operating center from Atari, Inc., a subsidiary of Warner Communications, Inc. At the close of fiscal year end 1981, 88 Pizza Time Theatres were operating in 20 states, Canada and Australia.

The Company completed its initial public stock offering in April 1981. The stock is currently traded in the over-the-counter market.

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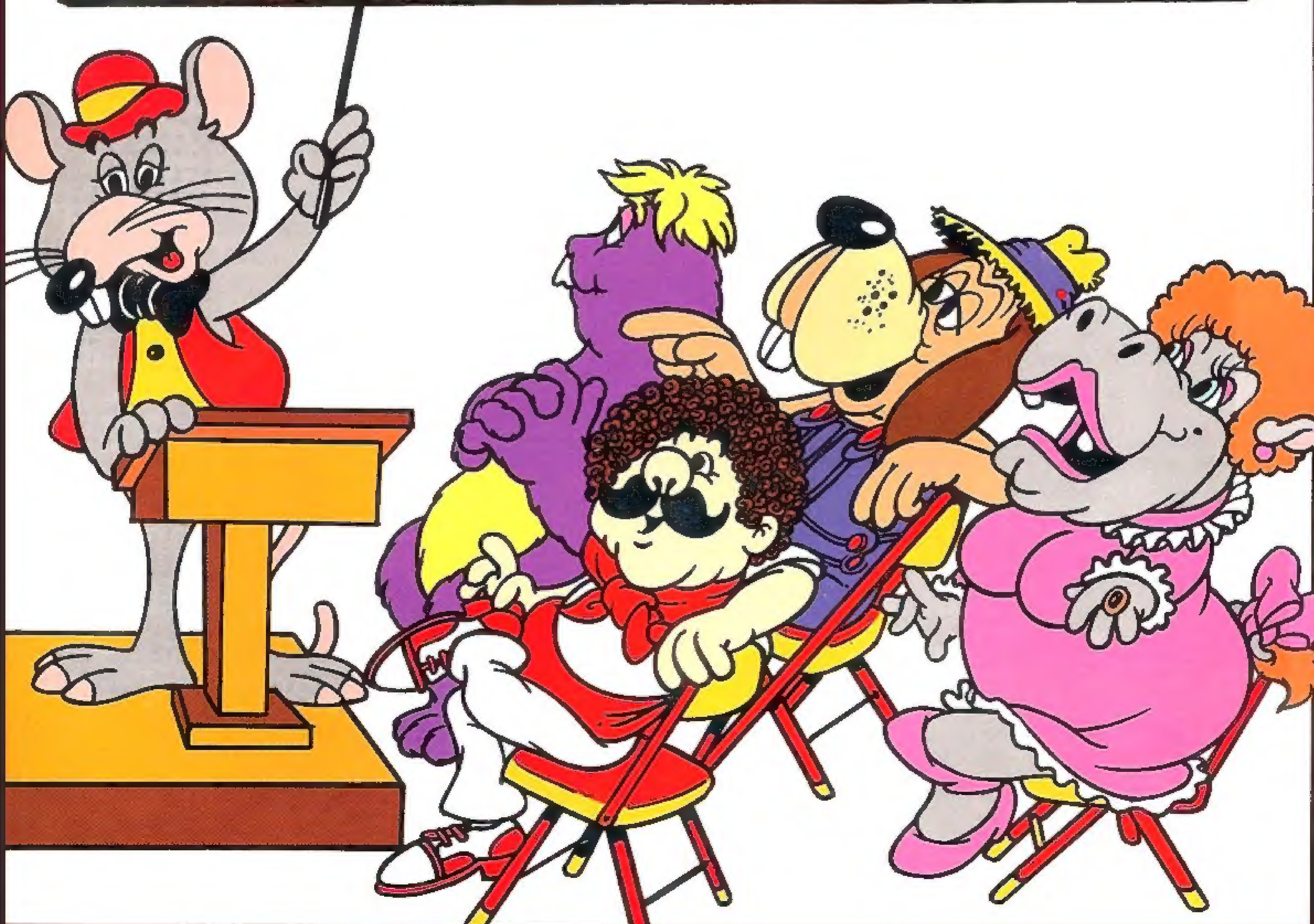
Financial Highlights

	1981	1980	1979	1978
Total Revenues	**$36,218,914**	$11,425,528	$ 3,065,739	$ 348,253
Net Income (Loss)	**$ 2,601,056**	$ 176,879	$ (1,324,307)	$ (525,037)
Earnings (Loss) Per Share	**$ .58**	$ .07	$ (.69)	$ (.29)
Centers In Operation	**88**	25	7	2
Total Assets	**$60,927,601**	$ 9,483,330	$ 3,471,977	$ 1,062,330
Shareholders' Equity (Deficit)	**$44,818,352**	$ 5,884,485	$ (576,344)	$ 107,963



Letter to the Shareholders

To Our Shareholders:

"A Star is Born" is the theme for our 1981 annual report, the first to be published since Pizza Time Theatre, Inc. went public last April. A look at the growth of our Company shows why Chuck E. Cheese's Pizza Time Theatre is destined to be one of the bright and shining stars of the leisure industry.

Overview of 1981 Financial Results

1981 was an outstanding year with financial results as follows:

- Total revenues of $36,218,914, a 217% increase over 1980 revenues.
- Net income of $2,601,056, or $.58 per share, a 729% increase over 1980 net income at $.07 per share.
- Revenues from Company centers of $29,547,007, a 217% increase over 1980.
- Royalties from franchise owners of $1,519,254, a 7,587% increase over 1980.

This performance is due to the opening of new centers, execution of franchise territorial agreements, improved operations and an aggressive marketing program.

Center Development

At fiscal year end, December 27, 1981, 88 Pizza Time Theatres were operating in 20 states, Canada and Australia. Half were Company-owned and half were franchised. Of the 63 new units opened during the year, 30 were Company-owned and 33 were franchised.

To date, Company centers are concentrated in California, Texas and Florida while franchise centers are located in 19 states, Canada and Australia. Territorial Development Letters of Agreement for franchising rights have been signed in most states where the Company intends to franchise.

Stock Offerings

The Company's growth over the past year was made possible by two stock offerings. The initial public offering in April added $12.5 million to capital, and an additional $24 million was raised through a second offering in November. Proceeds are being used to develop new Company centers.

Emphasis on Family Entertainment

As this report shows pictorially in the following pages, Pizza Time Theatre is a place for families to enjoy their leisure. In order to insure the wholesome family environment so important to the ongoing success of our concept, we continue to vigorously support a policy in the centers requiring that all children under 18 be accompanied by parents. Chuck E. Cheese, as both a performing robot and a walk-around mascot, continues to gain recognition nationwide, especially among children. With market research showing that children identified the centers as "Chuck E. Cheese's place," a new corporate logo and restaurant signage package was designed with added emphasis on our mascot.

Our Cyberamics entertainment system has evolved through three generations since the first Pizza Time Theatre opened in 1977. Moving from the first wall mounted picture frames with talking heads, we now have a cast of 15 characters or character sets, including traveling

Letter to the Shareholders

guest stars, who perform on stage or at a piano bar. Eleven different 90-minute musical skit tapes represent 15 hours of continuous programmed animated entertainment available for use in the restaurants.

Goals and Challenges

The Company hopes to open between 90 and 100 centers in 1982, at least half of which will be developed by franchise owners. Our plans also call for further expansion of our concept internationally in the years to come.

Another goal of the Company is continued improvement of store operations. Training programs for our restaurant managers emphasize the concept of offering customers quality, service and cleanliness in food operations as well as a total entertainment experience. We have recently opened a 5,000 square-foot training facility and test kitchen in San Jose, California to enhance our training capability and ongoing development of food products.

Research and development activities are being expanded to provide new products, systems and technologies needed for continued growth and future success.

Outlook

Our strong and capable franchise organization is an integral part of our success. We will continue our close working relationship, drawing on the experience of our franchise owners, and in turn, providing leadership and direction for ongoing growth and development.

I would like to thank our franchisees, as well as our officers and corporate employees for their creative spirit, dedication and hard work, and our shareholders for their confidence and support. Many people have contributed to the success of our Company. We plan to continue working toward making Chuck E. Cheese's not only the first, but the best and largest family dining and entertainment experience. The outlook is bright for Chuck E.'s star shining all over the U.S., and in more countries around the world in the years to come.

February 17, 1982

Joseph F. Keenan
President

Looking Ahead –

Quotations from the Chairman

"We will combine our knowledge of the restaurant industry with our understanding of technology to accomplish innovations that will help our productivity and the restaurant industry as a whole."

"Computer games are the training wheels for computer literacy. In the next several years we plan to take computer literacy a step further and be an instrumental part in helping American children to be as facile with the computer as they are with the English language."

"It is not axiomatic that learning needs to be drudgery and stressful. We will continue to strive for the happy educational environment."

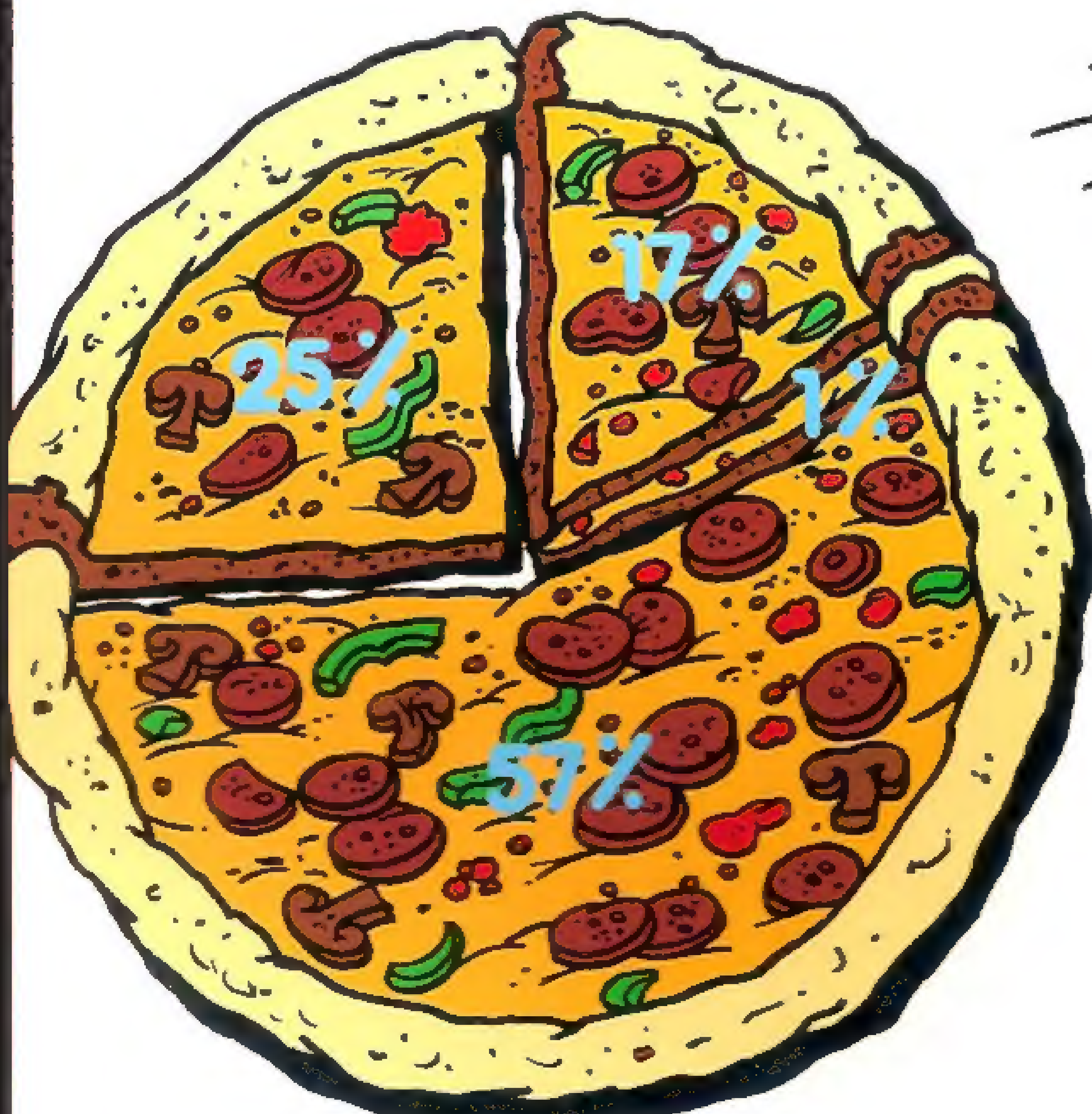
"Pizza Time Theatre has an interesting correlation to the movie industry of the thirties. It was essentially packaging entertainment for distribution in the theaters of America. At that time, moviemakers were on the cutting edge of their technology. We will be doing the same thing, on the cutting edge of today's technology, with our entertainment concept."

Nolan K. Bushnell
Chairman of the Board

Pizza Time Theatre Concept

Chuck E. Cheese's Pizza Time Theatre presents a new way for families to enjoy their leisure. Combining a pizza restaurant with the excitement of video games and other amusements, and a unique theatre of computer-controlled characters, the Pizza Time concept expands the dining-out experience into a total package of family entertainment. This combination of food, beverage and entertainment results in an average customer stay of one hour and 30 minutes.

Pizza Time Theatre has one of the best defined primary markets of any restaurant or entertainment operation that exists today – families with children age 15 and under – and the Company's success reflects our ability to serve that market.



Pizza Pie Chart of Company Center Sales Breakdown

57%	Food
25%	Games
17%	Beverage
1%	Merchandise

Pizza Time Theatre Concept

An important secondary market for Pizza Time Theatre is group business. With an average restaurant size of 12,000 square feet, Pizza Time encourages group sales. Our entertainment package and large seating capacity allow us to market with equal success to a soccer team of 20 or a bowling league of 200. Non-profit organizations are encouraged to use Pizza Time Theatre's Community Involvement Nights as a means of fund raising.

Pizza Time Theatre offers a restaurant and entertainment environment created especially for families.


MILK
Pizza Time Theatre
System-Wide
• Corporate Centers
• Franchise Centers*
*International Franchise: Surfers Paradise, Queensland, Australia and Burlington, Ontario, Canada

Pizzas are available in a variety of sizes and with a selection of popular toppings. Regional adaptations accommodate taste preferences in different areas of the country.

Pizza Time Theatre takes pride in serving high quality food emphasizing fresh wholesome ingredients. Centers nationwide have similar menus, with regional adaptations, featuring a variety of pizza selections, oven-baked sandwiches, salad and sundae bars, and beverages including wine and beer. Pizza dough is prepared fresh daily in all restaurant kitchens and only natural cheeses, premium meat toppings and other fine ingredients are used on the pizzas.

A new sandwich program introduced during the past year, and a special lunch promotion aimed toward working adults, increased daytime sales. New food items and food quality will continue to be emphasized as part of the ongoing marketing strategy.

Food products in the Company's centers are periodically tested for quality and conformity to Company standards.

The recently completed test kitchen housed in the San Jose training center will be used for ongoing testing and development of new products and menu items.

Center Operations

Bold interior signage directs customers to food and beverage order counters.

Pizzas hot from the oven are picked up at the adjoining food service area.

With food purchases, customers receive free game tokens good for playing any of the games, rides and other amusements in the Fantasy Forest Game Preserve. Double tokens given Mondays through Thursdays serve as an incentive to increase weekday attendance.

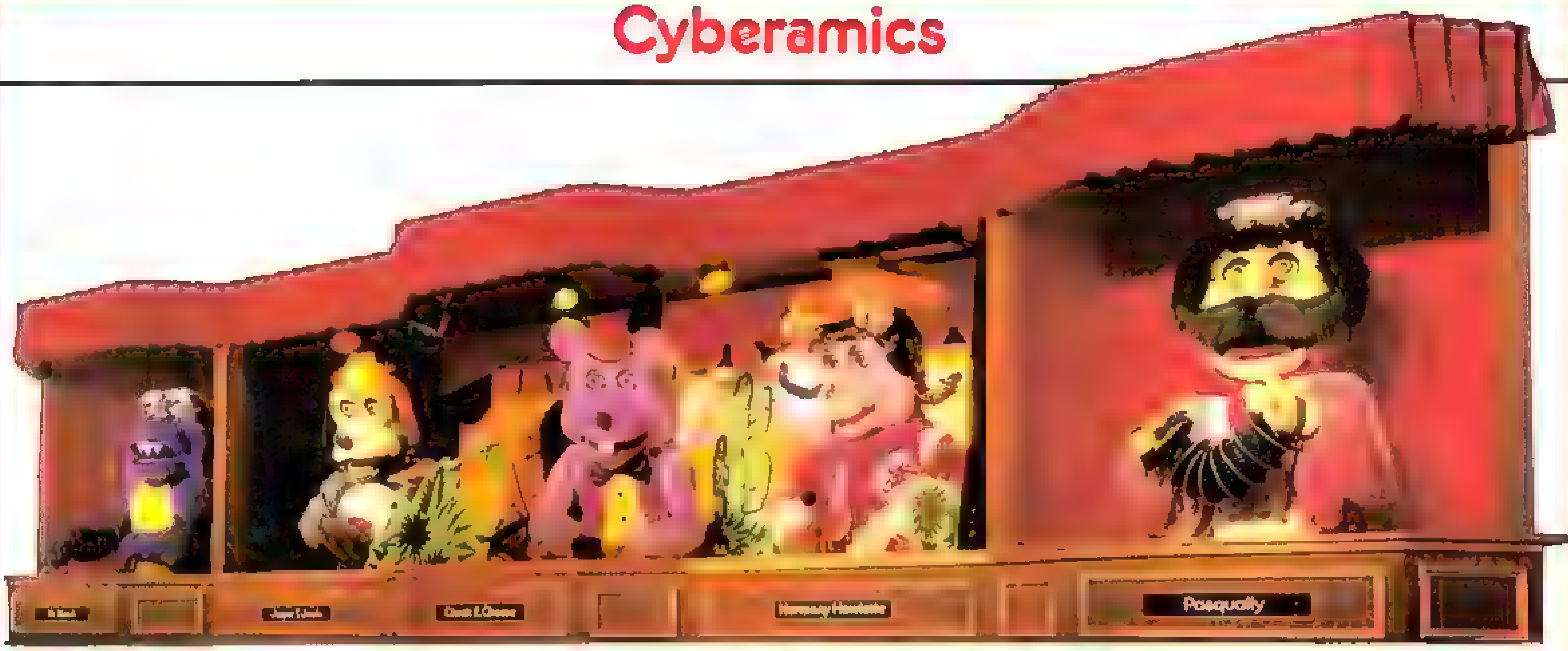
A variety of amusements for all ages are found in the game area. Arcade games such as air hockey and skeeball represent 20 to 30% of the total games while video games represent 30 to 40%. Kiddie rides such as rocket ships and carousels represent 15 to 40% of total center games.

Center Operations

Special play areas feature games and amusements for Pizza Time Theatre's younger customers.

In order to encourage family-oriented activity, the centers contain no pinball games, and the policy of not admitting children under 18 years of age unless accompanied by an adult will continue to be maintained.

Cyberamics

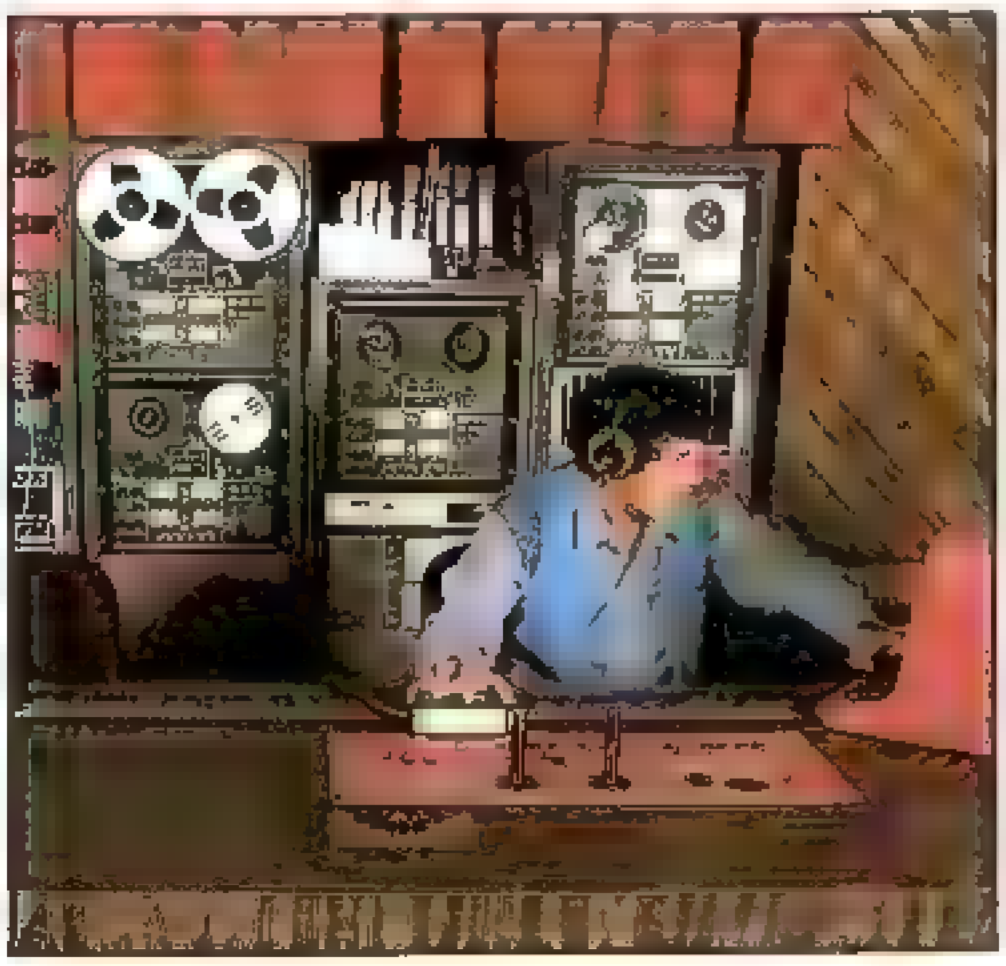


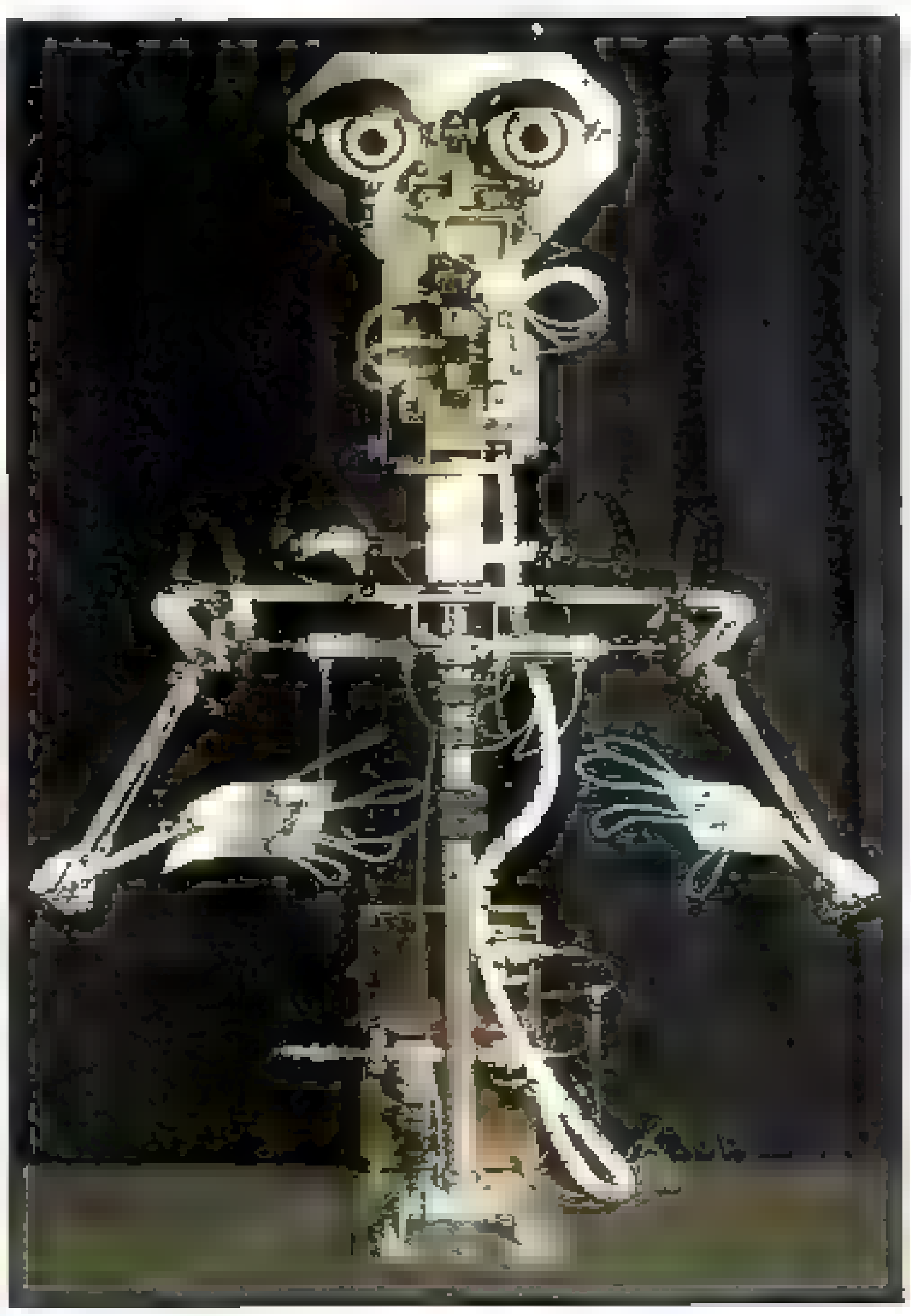
At the heart of Pizza Time Theatre's entertainment concept are the Pizza Time Players, a cast of original robot characters programmed with songs and dialogue. On stage in the theatre-dining room of every Pizza Time Theatre, these fully automated computerized characters strike up a two to four minute musical performance every 8 minutes. New guest stars and programs are added to the shows periodically. In addition to the theatre-dining room shows, more entertainment is found in the piano-bar cabaret, a quieter dining area with a token-operated character. Some of the larger restaurants also include a lounge room featuring additional token-operated musical entertainment.

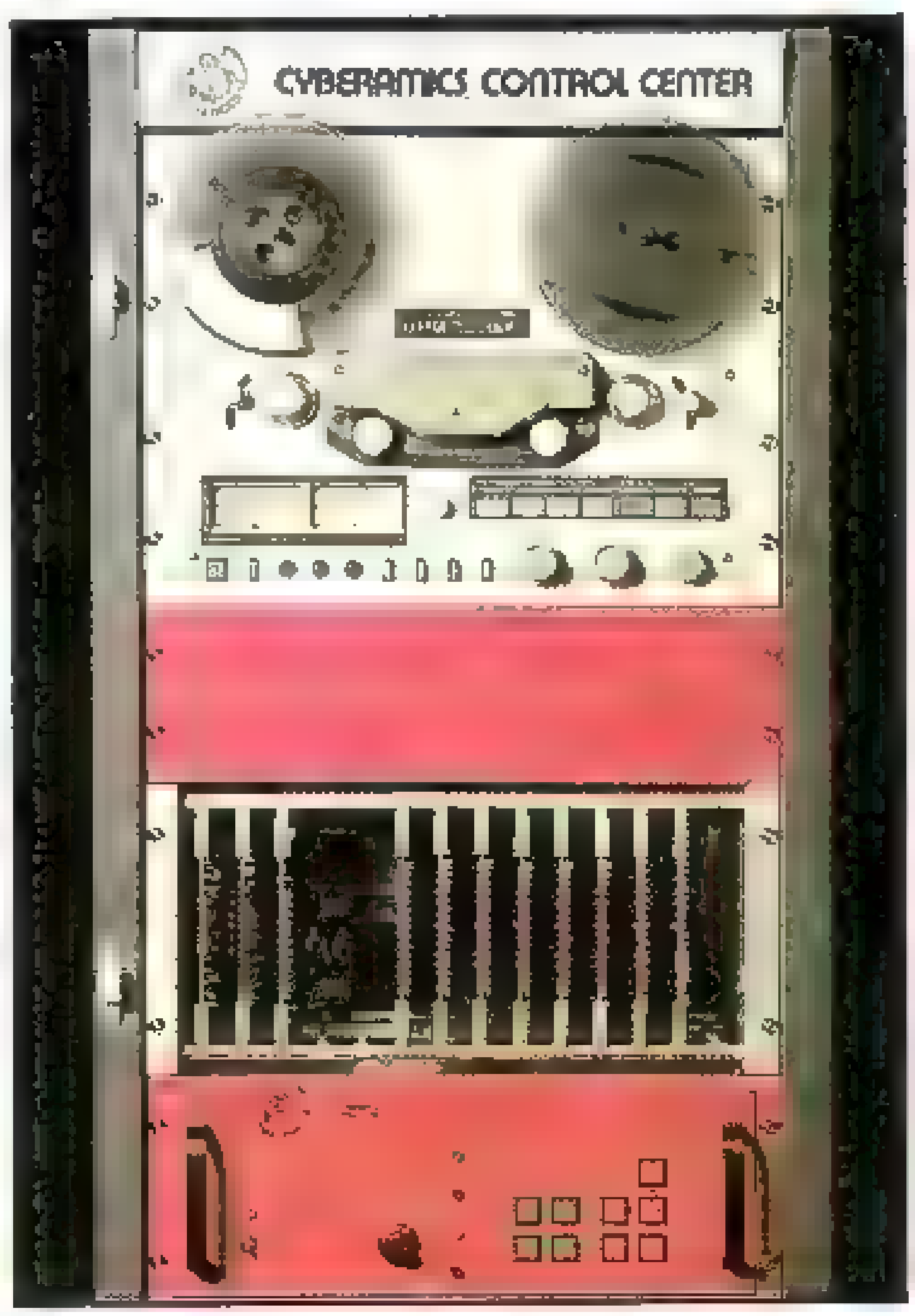
This entertainment system trademarked as "Cyberamics" currently includes 15 characters or character sets.

Technology

The Company designs, engineers and assembles all robot characters and their computer control system at the corporate headquarters. A staff of computer puppeteers creates software programs and designs all related tape encoding, program and reproduction systems. To facilitate mass production, the robot designs incorporate interchangeable parts and simplified production techniques. Television order/call out systems, token dispensers and other equipment are also designed, engineered and assembled at the manufacturing facility.







From left to right, Cyberamics tapes are generated at the programming console in the animation studio. A Cyberamics character begins with construction of a robot frame. Every restaurant has its own Cyberamics Control System.

Walk-Around Characters

Birthday parties are big business at Chuck E. Cheese's – a visit from Chuck E. himself makes the occasion even more special.

Chuck E. Cheese and the Pizza Time Players also appear as walk-around characters in the restaurants to the delight of young customers. A visit from Chuck E. Cheese himself is promoted as an important part of Pizza Time's successful birthday party package

offered in all centers. Use of the walk-around characters in a visitation program to schools, hospitals, sports activities and community events ensures maximum exposure and consumer recognition, and allows creative marketing of the Pizza Time concept outside the centers.

Cartoon Illustrations

Illustrations of the characters appear on promotional materials and advertisements, and on merchandise sold in all Pizza Time Theatre general stores.

Chuck E. Cheese's University

[illegible] operate the Cyberamics system as part of the three-week management training program at [illegible]'s University.

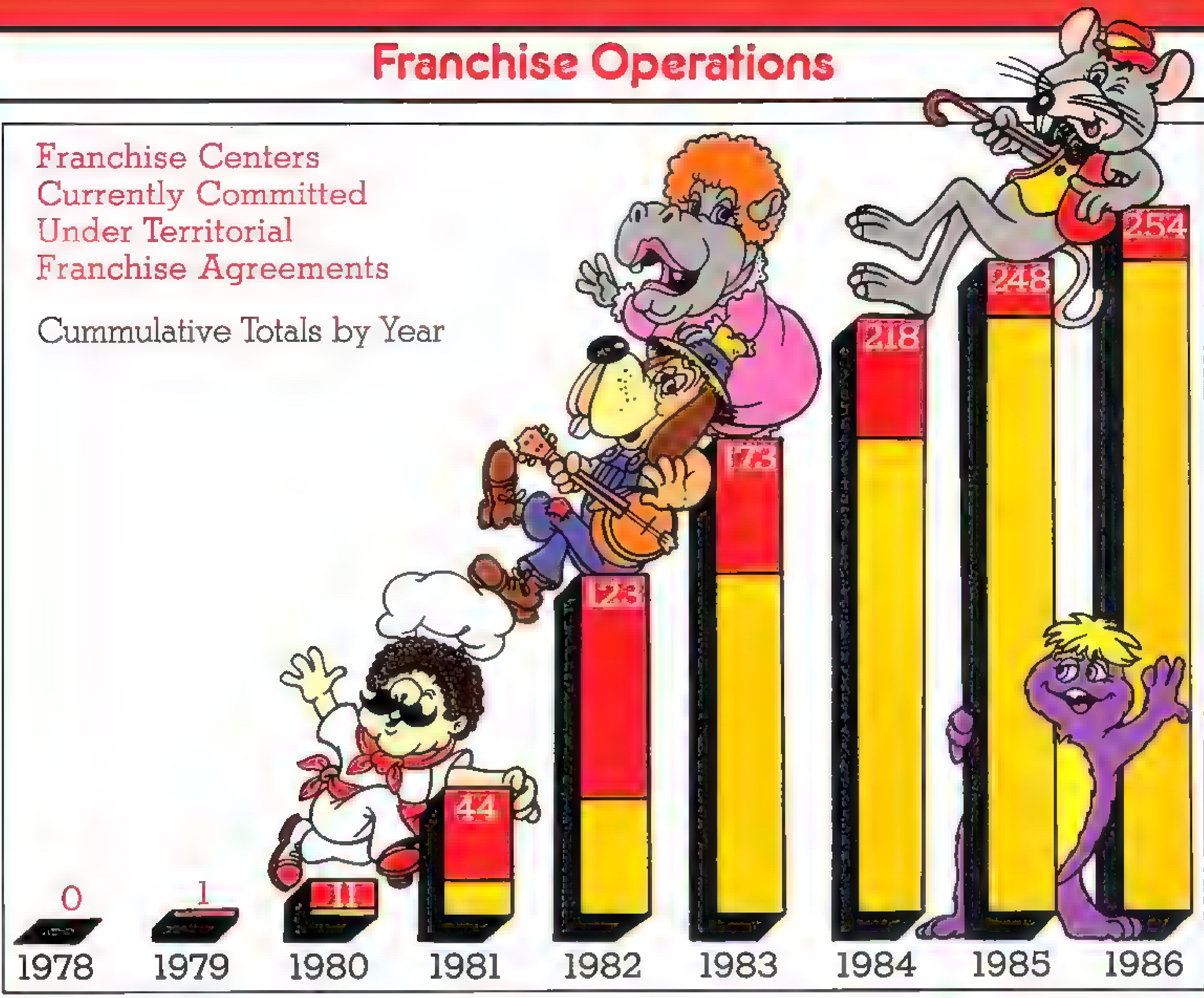
Pizza Time's philosophy of operating all centers in accordance with Company standards of food preparation, service and maintenance of premises, is supported by a thorough management training program.

Chuck E. Cheese's University was recently established with the completion of the new training center in San Jose, California. This facility provides classrooms, an audio-visual laboratory, a library and offices.

Regional branches of Chuck E. Cheese's University are located in Southern California, Texas and Florida.

Restaurant managers, franchise owners and corporate personnel complete a five-week program which includes three weeks of instruction at a training center and two weeks working experience in an operating center. Hourly employees receive in store training which includes testing and performance evaluations.

Franchise Operations



The Company has franchised on both a territorial and an individual unit basis, generally only in areas where there is no existing or planned concentration of Company centers. At the close of 1981, the Company had entered into Territorial Development Franchise Agreements with 26 persons and organizations.

The Company's standard franchise agreement grants the franchise owner the right to use the Company's trade names, trademarks, and service marks, and the right to develop and operate a center in accordance with the Company's system. The Company assists franchise owners with center development, operations and marketing programs.

Thirty-three franchise centers opened in 1981 including the first international units located in Surfer's Paradise, Queensland, Australia, and in Burlington, Ontario, Canada. Currently there are franchise commitments to open more than 200 additional centers over the next five years.

To facilitate communications between franchise owners and the Company, a franchise advisory council with regional representation was formed last year. The six-member council elected annually by the franchise owners meets once a quarter.

A Star is Born

The musical antics of the Pizza Time Players attract family groups to the main theatre-dining room. When the house lights dim, it's a signal the show is about to begin.

The theme of this annual report, "A Star is Born," refers to Pizza Time Theatre's debut as a public company, and to the growing recognition of Chuck E. Cheese, the corporate symbol. Our position in the leisure industry is reflected by continuing growth nationwide. It's a success story founded on the Company's basic concept…a wholesome entertainment and dining experience created especially for families.

Selected Financial Data

	Year Ended			Incorporation May 12, 1978 through December 3[illegible]
	December 27, 1981	December 28, 1980	December 30, 1979	1978
Selected Statements of Operations Data:				
Revenues from Company centers	$29,547,007	$ 9,336,444	$ 2,960,821	$ 347,45[illegible]
Initial franchise fees	1,105,000	750,000	20 000	—
Other franchise revenues	5,566,907	1,339,084	84,918	8[illegible]
Total revenues	36,218,914	11,425,528	3,065,739	348,2[illegible]
Net income (loss) before cumulative effect of change in accounting method	2,601,056	91,879	(1,324,307)	(525,0[illegible]
Cumulative effect on prior years of change in accounting method	—	85,000		
Net income (loss)	2,601,056	176,879	(1,324,307)	(525 03[illegible]
Net income (loss) per share before cumulative effect of change in accounting method	.58	04	(.69)	[illegible]
Cumulative effect per share on prior years of change in accounting method	—	03	—	—
Net income (loss) per share	.58	07	(69)	[illegible]
Pro forma net income (loss)(1)	2,601,056	91,879	(1,239,307)	(525 03[illegible]
Pro forma net income (loss) per share(1)	.58	04	(.64)	[illegible]
Weighted average shares outstanding	4,492,265	2,598 404	1,927,999	1,794 66[illegible]
Selected Balance Sheet Data:				
Working Capital	$21,501,928	$ 590,755	[illegible] 397,828	$ (477 9[illegible]
Total assets	60,927,601	9,483,330	3,471,977	1,062 3[illegible]
Long-term debt	4,562,170	1,155,807	1,750,000	300,0[illegible]
Total shareholders' equity (deficit)	44,818,352	5,884,485	(576,344)	107 9[illegible]

(1) Pro forma amounts assume the current accounting method was applied retroactively See Notes to Financial Statements

Management's Discussion and Analysis

Overview

The Company's growth in revenues and income is principally due to substantial growth in the number of Company and franchised centers opened during the last two years. The following table shows number of centers in operation at fiscal year end 1979, 1980 and 1981.

	December 30, 1979	December 28, 1980	December 27, 1981
Company centers	6	14	44
Franchised centers	1	11	44
Total	7	25	88

Revenues from Company centers consist of total sales of the centers. Franchise fees include initial fees paid to the Company for individual center franchises (currently $20,000 per center) and for territorial franchises. The Company's territorial franchise agreement grants a right to develop a number of franchises within a specified territory upon payment of a non-refundable fee of $5,000 per location. When a franchised center is opened under this arrangement the initial franchise fee due is reduced by the non-refundable fee previously paid. Other franchise revenues include equipment sales, continuing payments to the Company under franchise agreements (currently 6% of franchised center gross sales) and sales of certain merchandise. Equipment and merchandise are sold to franchise owners at prices which currently approximate cost.

Results of Operations 1981 compared with 1980

Revenues from Company centers in fiscal 1981 increased over fiscal 1980 primarily as a result of 30 new centers opened during fiscal 1981 and increased revenues from existing centers opened in fiscal 1980.

The increase in initial franchise fees was the result of income received from 33 franchised centers opened during fiscal 1981 as compared to 10 franchised centers opened during fiscal 1980. Initial franchise fees in fiscal 1981 and fiscal 1980 included $605,000 and $575,000, respectively, related to non-refundable fees from the sale of rights to develop multiple franchises within a specified territory. The Company expects that it will discontinue offering rights to develop multiple franchises during the latter part of 1982, except in certain circumstances. Accordingly, these fees will not contribute significantly to operations in the future. The Company will, however, continue to receive initial franchise fees upon the opening of franchised centers.

The increase in other franchise revenues was principally due to the sale of Cyberamics to franchise owners, royalty revenues from additional franchised centers in operation and increased revenues of existing franchised centers.

Engineering and product costs include amounts related to the production of Cyberamics for both Company and franchised centers and the cost of other items sold to franchise owners. These costs increased proportionately as a result of the greater number of Company and franchised centers.

Management's Discussion and Analysis

Selling, general and administrative expenses increased in 1981 as a result of the expansion of the Company's operations. However, these expenses decreased from 25.1% of total revenues in 1980 to 20.7% of total revenues during 1981.

The Company raised approximately $36,000,000 from the sale of Common Stock to the public in 1981. These funds are invested in short-term interest-bearing securities pending utilization. During 1981 interest income from such investments was approximately $1,070,896 ($879,000 net of interest expense). Interest expense in 1980 was $244,000.

Approximately half of the Company center openings in fiscal 1981 occurred during the fourth quarter. This provided a large investment tax credit which, together with an investment tax credit carryforward from 1980, resulted in an overall effective tax rate of approximately 20% for fiscal 1981. The Company expects that its effective tax rate in 1982 will be higher than that in 1981.

Net income after provision for federal and state taxes increased from $176,879 in 1980 to $2,601,056 in 1981. This represents an increase from $.07 per share in 1980 to $.58 per share in 1981. Net income per share did not increase at the same rate as net income due to a substantial increase in the number of shares outstanding principally as a result of the issuance of 900,000 shares of Common Stock in an initial public offering in April 1981 and 1,033,166 shares of Common Stock in a second public offering in November 1981.

1980 compared with 1979

Revenues from Company centers in fiscal 1980 increased over fiscal 1979 primarily as a result of eight additional centers opened during the year and increased revenues from centers opened in late fiscal 1979. Losses in fiscal 1979 were due to continuing developmental efforts and costs incurred in opening four Company centers, which costs were expensed in fiscal 1979. Three of these four centers were opened during the last half of the year and consequently related expenses were disproportionate to revenue contributions.

Fiscal 1980 was the first year in which the Company recognized significant franchise revenues. Initial franchise fees of $750,000 recognized in fiscal 1980 revenues included $175,000 related to the opening of 10 new franchised centers and $575,000 related to non-refundable fees from sales of rights to develop multiple franchises within a specified territory. In fiscal 1980 the Company changed its method of accounting to recognize territorial development fees as income when the agreement is executed. In prior years, territorial development fees were deferred and recorded as income when the related stores were opened. The current method was adopted in

Management's Discussion and Analysis

recognition of the fact that the Company has provided substantially all services and satisfied all obligations assumed under the territorial development agreements when such agreements have been executed. The effect of the change in 1980 was to increase net income from operations in fiscal 1980 by approximately $[illegible]00 and to add a non-recurring item of $[illegible] to net income to take account of the cumulative effect of the change on prior periods.

Liquidity and Capital Resources

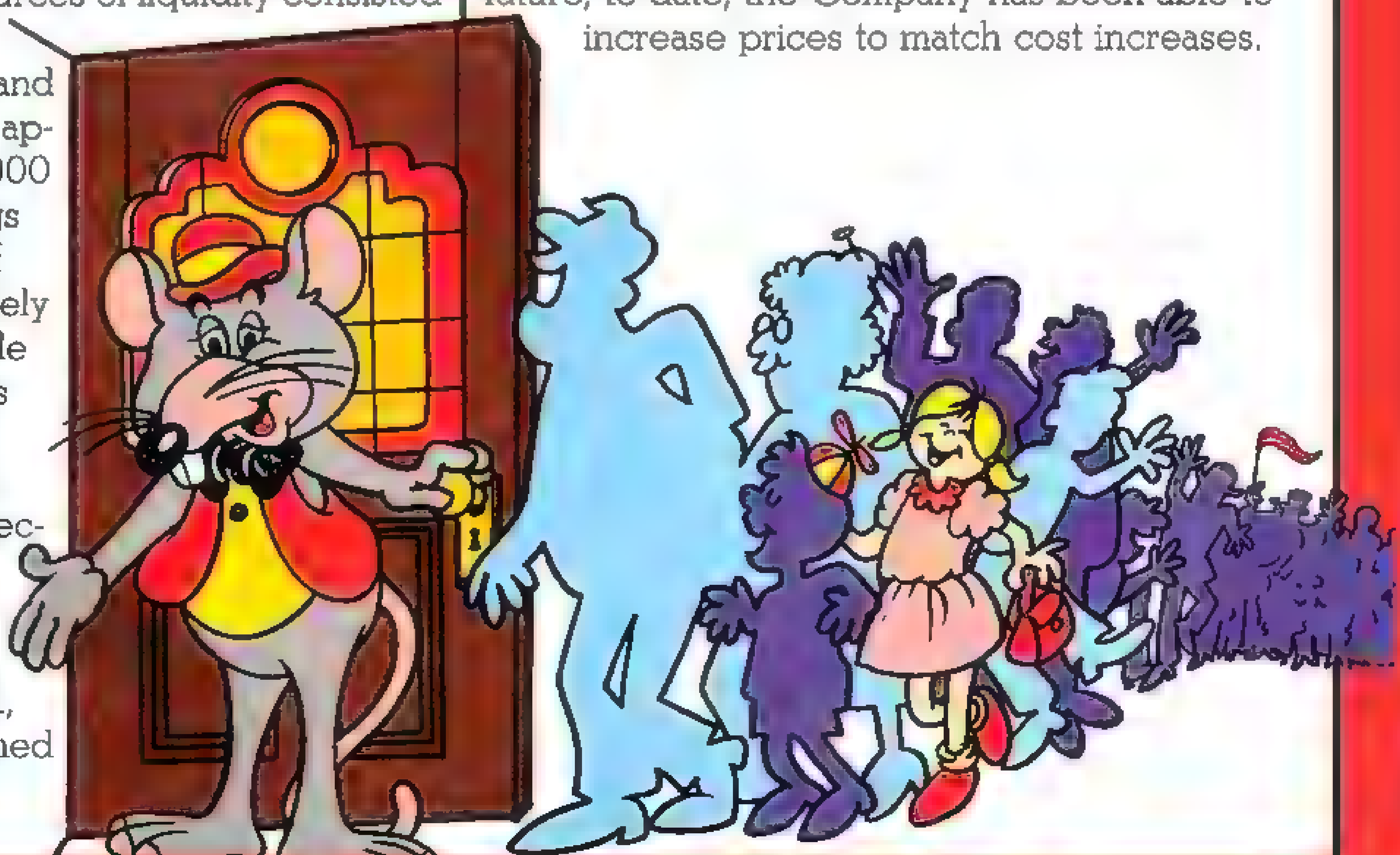
Rapid development of Company centers has required and will require substantial working capital, and cash flow from operations is not sufficient to meet all of such cash needs. In prior years the Company financed its growth through private sales of equity and debt securities, bank borrowings and equipment leases. The Company expects that the remaining proceeds of its 1981 stock offerings, together with cash flow from operations, equipment leases and the Company's existing bank lines of credit will be sufficient to meet working capital needs through fiscal 1982, although the Company may seek additional or alternative financing depending upon the terms and availability of credit.

At December 27, 1981, the Company's principal unutilized sources of liquidity consisted of approximately $[illegible],000 in cash and certificates of deposit, approximately $10,000,000 of available borrowings under its bank lines of credit and approximately $[illegible]00 of available commitments under its equipment lease agreements.

The Company's objective is to open about 40 new Company centers in fiscal 1982. At December 27, 1981, the Company had signed leases for 35 centers which had not yet been remodeled or occupied. The Company expects that cash expenditures of $450,000 to $750,000 will be required for each center. The Company expects to fund these cash requirements from the sources discussed above.

Impact of Inflation

Significant inflationary factors related to the Company's operations include food and labor costs and occupancy costs of premises. Many employees are paid hourly rates related to the Federal minimum wage. Accordingly, inflation-related increases in the minimum wage have increased, and may continue to increase, the Company's costs. Higher costs, coupled with uncertainty among financial institutions about making long-term, fixed-rate mortgage commitments in a period of volatile interest rates, have significantly increased the costs of lessors and developers who lease centers to the Company and, accordingly, have increased rentals under such leases. Furthermore, most of the present leases contain periodic escalations of annual rentals based upon increases in specified cost-of-living indices. The Company expects that most of its future leases will contain similar provisions. Although no assurances can be given as to the future, to date, the Company has been able to increase prices to match cost increases.



Balance Sheets

December 27, 1981 and December 28, 1980

	1981	1980
Assets		
Current assets:		
Cash and cash equivalents	$22,178,796	$ 194,169
Receivables	2,364,062	661,021
Inventory	6,523,754	1,665,506
Prepaid expenses	429,380	144,58[illegible]
Total current assets	31,495,992	2,665,278
Long-term receivables	145,000	145,00[illegible]
Property, equipment and leasehold improvements at cost less accumulated depreciation and amortization	27,170,011	6,077,03[illegible]
Other assets	2,116,598	596,02[illegible]
	$60,927,601	$ 9,483,33[illegible]
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 7,329,147	$ 1,515,96[illegible]
Accrued liabilities	1,555,019	394,[illegible]
Income taxes payable	317,000	—
Current installments of long-term debt	792,898	164,4[illegible]
Total current liabilities	9,994,064	2,074,5[illegible]
Long-term debt, excluding current installments	4,562,170	1,155,8[illegible]
Deferred income	1,219,015	368,5[illegible]
Deferred income taxes	334,000	—
Shareholders' equity:		
Preferred stock. Authorized 1,333,333 shares; outstanding 730,980 shares in 1980	—	3,323,9[illegible]
Class A preferred stock. Authorized 10,000,000 shares; none outstanding	—	—
Common stock. Authorized 20,000,000 shares; outstanding 5,692,411 shares in 1981, 2,925,746 in 1980	43,889,761	4,233,[illegible]
Retained earnings (accumulated deficit)	928,591	(1,6[illegible])
Total shareholders' equity	44,818,352	5,884,4[illegible]
	$60,927,601	$ 9,483,[illegible]

See accompanying notes to financial statements

Statements of Operations

[illegible] ded December 27, 1981, December 28, 1980 and December 30, 1979

	1981	1980	1979
[illegible]:			
[illegible] centers	$29,547,007	$ 9,336,444	$ 2,960,821
[illegible] franchise fees	1,105,000	750,000	20,000
[illegible] franchise revenues	5,566,907	1,339,084	84,918
[illegible] revenues	36,218,914	11,425,528	3,065,739
[illegible] expenses:			
[illegible] centers:			
[illegible] sales	13,472,154	4,234,314	1,261,372
[illegible] expenses	10,035,931	2,842,133	926,617
[illegible] and product costs	2,834,582	1,142,474	362,321
[illegible] general and administrative expenses	7,503,188	2,871,061	1,709,578
[illegible] expense (income), net	(878,997)	243,667	130,158
[illegible] costs and expenses	32,966,858	11,333,649	4,390,046
[illegible] loss) before income taxes and cumulative effect of change [illegible] accounting method	3,252,056	91,879	(1,324,307)
[illegible] taxes	651,000	—	—
[illegible] loss) before cumulative effect of change in accounting method	2,601,056	91,879	(1,324,307)
[illegible] effect on prior years of change in accounting method	—	85,000	—
Net income (loss)	$ 2,601,056	$ 176,879	$ (1,324,307)
[illegible] (loss) per common share and common share equivalent			
[illegible] loss) before cumulative effect of change in accounting method	$ 0.58	$ 0.04	$ (0.69)
[illegible] effect on prior years of change in accounting method	—	0.03	—
[illegible] loss) per common share and common share equivalent	$ 0.58	$ 0.07	$ (0.69)
[illegible] amounts assuming the current accounting method was applied retroactively:			
[illegible] loss)	$ 2,601,056	$ 91,879	$ (1,239,307)
[illegible] loss) per common share and common share equivalent	$ 0.58	$ 0.04	$ (0.64)
[illegible] average number of common shares and common share [illegible] outstanding	4,492,265	2,598,404	1,927,999

[illegible] accompanying notes to financial statements

Statements of Shareholders' Equity

Three years ended December 27, 1981, December 28, 1980 and December 30, 1979

	Common Stock		Preferred Stock		Retained Earnings (Accumulated Deficit)	Total
	Number of Shares	Amount	Number of Shares	Amount		
Balance at December 31, 1978	1,794,666	$ 633,000	–	$ –	$ (525,037)	$ 107,963
Additional contributed capital	–	40,000	–	–	–	40,000
Conversion of debt to common stock	400,000	600,000	–	–	–	600,000
Net loss	–	–	–	–	(1,324,307)	(1,324,307
Balance at December 30, 1979	2,194,666	1,273,000	–	–	(1,849,344)	(576,344
Sale of stock under stock option plans	82,662	123,993	–	–	–	123,993
Sale of stock through private placements	471,276	1,966,050	690,980	3,173,907	–	5,139,957
Conversion of debt to common and preferred stock	177,142	870,000	40,000	150,000	–	1,020,0[illegible]
Net income	–	–	–	–	176,879	176,8[illegible]
Balance at December 28, 1980	2,925,746	4,233,043	730,980	3,323,907	(1,672,465)	5,884,46[illegible]
Sale of stock under stock option plans	102,519	394,467	–	–	–	394,46[illegible]
Sale of stock to public	1,933,166	35,938,344	–	–	–	35,938,3[illegible]
Conversion of preferred to common stock	730,980	3,323,907	(730,980)	(3,323,907)	–	–
Net income	–	–	–	–	2,601,056	2,601,0[illegible]
	5,692,411	**$43,889,761**	**–**	**$ –**	**$ 928,591**	**$44,818,352**

See accompanying notes to financial statements

Statements of Changes in Financial Position

Three years ended December 27, 1981, December 28, 1980 and December 30, 1979

	1981	1980	1979
Sources of working capital.			
Net income (loss)	$ 2,601,056	$ 176,879	$ (1,324,307)
Items which do not use working capital:			
Depreciation and amortization	2,344,499	785,605	301,634
Deferred income taxes	334,000	—	—
Net book value of property and equipment dispositions	71,275	94,429	76,138
Working capital provided (used) by operations	5,350,830	1,056,913	(946,535)
Additions to notes payable due principal shareholder	—	—	1,020,000
Proceeds from long-term borrowings	11,411,149	5,603,275	1,550,000
Additions to deferred income	850,500	174,750	193,765
Conversion of debt to common and preferred stock and contributions to capital	—	1,020,000	640,000
Sale of stock	36,332,811	5,263,950	—
	$53,945,290	$13,118,888	$ 2,457,230
Uses of working capital:			
Additions to long-term receivables	$ —	$ 145,000	$ —
Additions to property, equipment and leasehold improvements	23,508,754	4 248 661	2,247,134
Additions to other assets	1,520,577	519,176	29,942
Conversion of debt to common and preferred stock	—	1,020,000	—
Current installments and repayment of long-term debt	8,004,786	6,197,468	100,000
Increase in working capital	20,911,173	988,583	80,154
	$53,945,290	$13,118,888	$ 2,457,230
Changes in components of working capital:			
Increase (decrease) in current assets:			
Cash and cash equivalents	$21,984,627	$ 66,772	$ 74,751
Receivables	1,703,041	602,258	39,028
Inventory	4,858,246	1,236,225	419,626
Prepaid expenses	284,800	73,295	(23,062)
	28,830,714	1,978,550	510,343
Increase (decrease) in current liabilities:			
Accounts payable	5,813,162	911,495	126,111
Accrued liabilities	1,160,958	13,995	—
Income taxes payable	317,000	—	—
Current installments of long-term debt	628,421	64,477	(10,000)
	7,919,541	989,967	430,189
Increase in working capital	$20,911,173	$ 988,583	$ 80,154

See accompanying notes to financial statements

Notes to Financial Statements

Three years ended December 27, 1981, December 28, 1980 and December 30, 1979

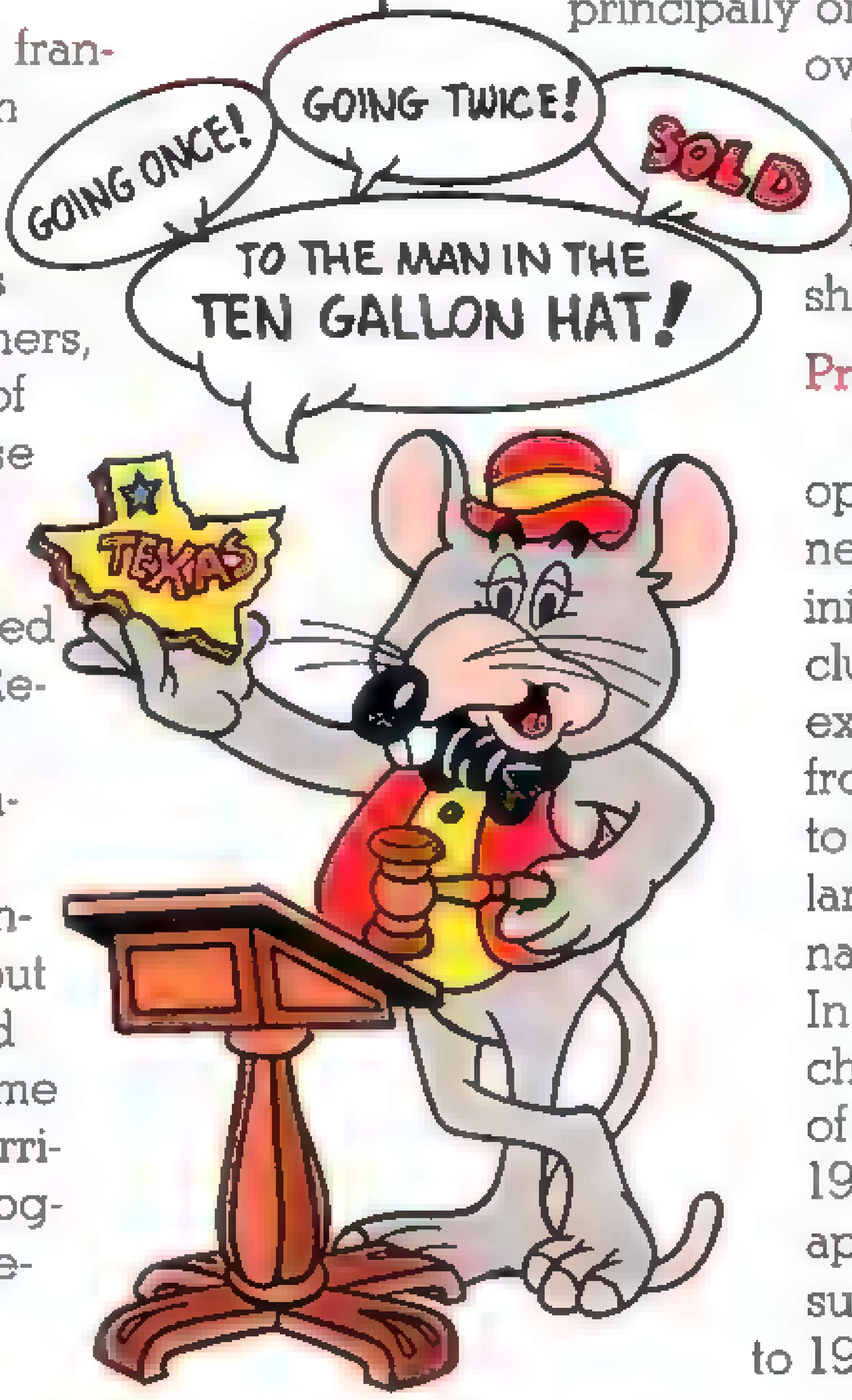
Summary of Significant Accounting Policies

Royalty and service fees from franchise operations are recorded in income on the accrual basis as earned. These revenues, as well as revenues received from sales of merchandise to franchise owners, are included in the Statements of Operations under other franchise revenues.

Revenue from the sale of Cyberamics is included in deferred income until time of shipment. Related costs in approximately the same amounts as revenue are included under engineering and product development. Initial franchise fees which are received but not yet earned are also included in deferred income until such time a franchise center is opened. Territorial development fees are recognized as income when the agreement is executed.

Territorial Development Fees

In 1980, the Company changed its method of accounting for territorial development fees to recognize income when the agreement is executed. In prior years, territorial development fees were deferred and recorded as income when the related centers were opened. The current method of revenue recognition for territorial development fees was adopted in recognition of the fact that the Company has provided substantially all services and satisfied all obligations assumed under the territorial development agreements when such agreements have been executed. The effect of the change in 1980 was to increase net income before cumulative change by approximately $550,000. The adjustment of $85,000 related to prior years is included in income in 1980.



Inventories

Inventories are stated at the lower of cost (first-in, first-out basis) or market (net realizable value).

Depreciation and Amortization

Depreciation and amortization are provided principally on the straight-line method over the estimated useful lives of the respective assets. Leasehold improvements are amortized over the shorter of asset life or lease term.

Pre-opening Expenses

Beginning in 1980, pre-opening expenses related to new company centers are initially capitalized and included in other assets and expensed over 12 months from the opening date. Prior to 1980, such costs were largely developmental in nature and were expensed. In 1980 the effect of this change was to defer $317,000 of such costs from 1980 to 1981. At December 27, 1981 approximately $1,292,000 of such costs were deferred to 1982.

Income Taxes

Deferred income taxes result from timing differences in the recognition of certain revenue and expense items for tax and financial reporting purposes. Investment tax credits are recorded as a reduction of the provision for Federal income taxes in the year realized.

Engineering and Product Costs

Engineering and product costs consist of costs associated with the manufacture of Cyberamics and other products related to franchised and Company centers. It is impractical for the Company to separate research and development from sustaining engineering costs. Both types of expenses are charged against income as incurred.

Notes to Financial Statements

Earnings Per Common Share

Earnings per common share and common share equivalent are based on the weighted average number of shares outstanding and equivalent shares from dilutive stock options.

Receivables

A summary of receivables is as follows:

	1981	1980
Trade accounts	$1,600,030	$ 556,478
12% notes receivable due at various dates from 1981 to 1983	145,000	200,000
Royalties and interest receivable	764,032	49,543
Total receivables	2,509,062	806,021
Less amounts due after one year	145,000	145,000
Current portion of receivables	$2,364,062	$ 661,021

Inventories

Inventories are as follows:

	1981	1980
[illegible] beverage, merchandise [illegible] supplies	$1,234,985	$ 397,045
[illegible] materials – Cyberamics	768,579	323,370
[illegible]-process – Cyberamics	658,501	227,867
[illegible]ed goods – Cyberamics	954,983	130,000
[illegible] and other equipment	2,906,706	587,226
	$6,523,754	$1,665,508

Property, Equipment and Leasehold Improvements

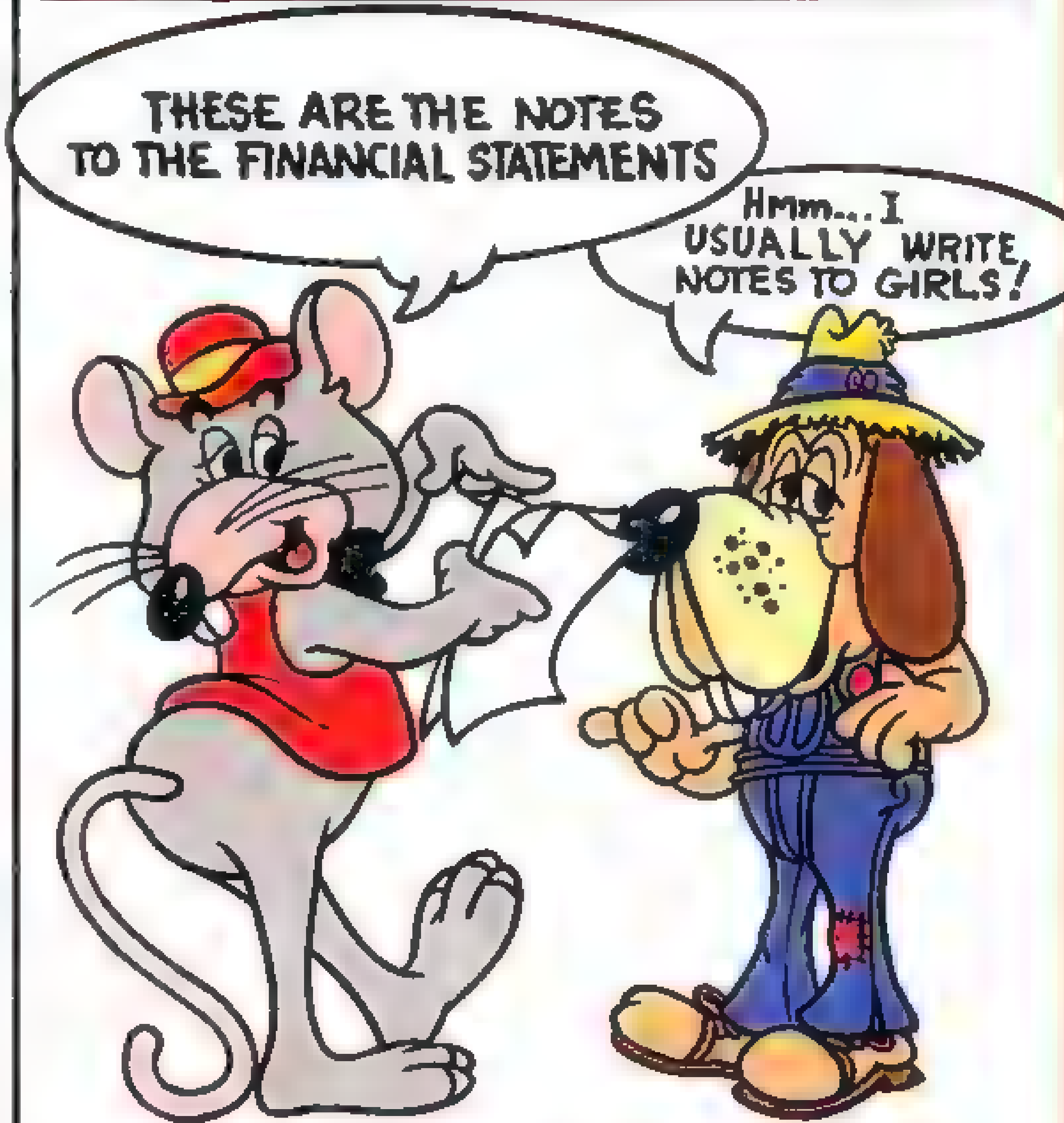
[illegible] summary of property, equipment and [illegible] improvements is as follows:

	1981	1980
[illegible]	$ 995,962	$ 765,378
[illegible] operated amusement [illegible]	6,887,417	1,686,329
[illegible] equipment	3,376,986	1,463,860
[illegible] equipment	581,005	255,773
[illegible]	330,000	—
[illegible]	600,000	—
[illegible]ements	84,604	—
[illegible] improvements	12,900,823	2,820,018
[illegible] under [illegible]	4,800,093	220,000
	30,556,890	7,211,358
[illegible] depreciation [illegible]	3,386,879	1,134,327
	$27,170,011	$6,077,031

Accrued Liabilities

Accrued liabilities are as follows:

	1981	1980
Payroll and related items	$ 805,940	$ 111,599
Sales taxes	328,971	82,957
Other	420,108	199,505
	$1,555,019	$ 394,061



Long-term Debt and Notes Payable

A summary of long-term debt is as follows:

	1981	1980
Note payable to Atari, Inc. for acquisition of assets in connection with the organization of the Company, due in annual installments of $100,000 plus interest at prime plus 1/2%	$ 100,000	$ 202,565
Note payable under bank line of credit	—	900,000
Mortgage notes payable at interest rates from 9-10-1/2%, secured by property and due in equal monthly installments through 2001	730,489	
Obligations under capital leases	4,524,579	217,719
	5,355,068	1,320,284
Less current installments of long-term debt	792,898	164,477
Long-term debt, excluding current installments	$4,562,170	$1,155,807

Notes to Financial Statements

The Company has a bank line of credit which expires January 3, 1983. The agreement provides that borrowings under the line are due on January 3, 1983. Borrowings under the bank line bear interest at prime which was 16% at December 27, 1981. The maximum borrowings under the bank line cannot exceed $7,500,000. If the Company does not maintain a compensating balance of $525,000, the effective interest rate is adjusted. The bank line imposes certain restrictions on the Company regarding additional indebtedness. As of December 27, 1981 and December 28, 1980, the Company was in compliance with the terms of the bank line.

In August 1981, the Company purchased the land and buildings of a shopping center for $248,263 in cash and assumption of various mortgage obligations totalling approximately $751,440.

The Company also has a commitment from a bank for a revolving loan of $2,500,000 to be utilized for construction of Company centers. The revolving credit converts to a four-year term loan in 1984. The loans bear interest at prime on the revolving portion and at prime plus 1/2% on the term portion. The Company will be required to maintain compensating balances and to pay a commitment fee of 1/2% per annum on the unused portion of the commitment. Construction loans must be refinanced within 18 months and the Company will be required to maintain specified ratios of debt-to-equity and earnings-to-fixed charges. There have been no borrowings under this line as of December 27, 1981.

The principal payments required on long-term debt for the next five fiscal years are: 1982 – $792,898; 1983 – $849,685; 1984 – $1,042,012; 1985 – $1,273,045 and 1986 – $748,050.

Shareholders' Equity

On February 23, 1981, the shareholders of the Company approved a two-for-three reverse stock split for both common and preferred stock which reduced the outstanding shares at December 28, 1980 to 2,925,746 and 730,980 respectively. The authorized shares of Common Stock were increased to 20,000,000 shares, and 10,000,000 shares of Class A Preferred Stock were authorized. An automatic conversion of 730,980 shares of Preferred Stock into an equal number of shares of Common Stock was effected as of April 16, 1981. All references in the financial statements to the number of shares and related per share amounts have been restated to reflect the foregoing matters.

In January and October 1980, loans from the principal shareholder totalling $1,020,000 were converted to 177,142 shares of common stock and 40,000 shares of preferred stock. The loans from the principal shareholder were in the form of notes bearing interest at 8%.

As of December 27, 1981, the Company had authorized 466,666 shares of common stock for issuance under the Company's Employee Stock Option Plan and 16,666 shares under the Incentive Stock Option Plan.

Under the Company's Employee Stock Option Plan, stock options may be granted to employees (including officers and directors) at prices not less than fair value at the date of grant. All options have five-year terms and generally options are exercisable commencing one year from the date of grant in cumulative annual installments of 33-1/3%. At December 27, 1981, and December 28, 1980, options covering 144,609 and 51,440 respectively, were exercisable under this plan.

Notes to Financial Statements

A summary of 1981 and 1980 transactions under the Employee Stock Option Plan is as follows:

	1981		1980	
	Number of Shares	Exercise Prices	Number of Shares	Exercise Prices
Outstanding at beginning of year	252,848	$1.50- 3.90	290,388	$1.50
Granted	145,265	5.25-21.50	56,451	3.90
Exercised	89,187	1.50-18.125	82,662	1 50
Cancelled or expired	2,299	3.90-18.125	11,329	1.50-3.90
Outstanding at end of period	306,627	1.50-21.50	252,848	1.50-3 90

The terms of the Incentive Stock Option Plan are similar to those of the Employee Stock Option Plan, except that options are immediately exercisable. At December 27, 1981, options covering 3,333 shares under the Incentive Stock Option Plan were outstanding and options covering 13,332 shares had been exercised.

The Company has also granted a leasing company an option to purchase 66,666 shares of common stock at an exercise price of $18 per share.

The Company has never declared or paid a cash dividend and anticipates that, for the foreseeable future, its earnings will be retained for use in its business.

Capital Leases

The Company has entered into various agreements with numerous parties which provide lease financing for equipment for Company centers. At December 27, 1981 and December 28, 1980, the Company had leased equipment for 20 centers and one center, respectively, with terms ranging from five to seven years. As of December 27, 1981 lease financing has been arranged for an additional 20 centers for an aggregate of $6,000,000. Under these agreements, the Company is required to meet certain net worth, working capital and ratio tests.

The following is a schedule of future minimum lease payments together with the present value of the net minimum lease payments as of December 27, 1981:

1982	$1,454,738
1983	1,451,626
1984	1,451,626
1985	1,445,876
1986	743,006
Thereafter	165,000
Minimum future lease payments	6,711,872
Less amounts representing interest	2,187,293
Present value of minimum future lease payments	4,524,579
Less current portion	666,363
Long-term portion	$3,858,216

Income Taxes

The Company had elected to be taxed as a Subchapter S corporation in 1978 and 1979. Accordingly, the accompanying financial statements include no tax provision or tax benefit from operating losses in those years. The Subchapter S election was revoked by the Company in 1980, thereby making the Company subject to Federal income taxes. However, there was no Federal income tax liability in 1980 as the Company had a foreign tax offset and investment tax credits of $24 500

Notes to Financial Statements

and $292,000 respectively.

Income tax expense for the year ended December 27, 1981 consists of:

	Current	Deferred	Total
Federal	$ 54,000	$300,000	$354,000
State	263,000	34,000	297,000
	$317,000	$334,000	$651,000

The provision for income taxes differs from the amount computed by applying the U.S. Federal statutory corporate rate to income before taxes. The reasons for the differences and the tax effect of each are as follows for the year ended December 27, 1981.

Computed "expected" tax expense	$1,495,946	46.0 %
State income taxes, net of Federal income tax benefit	160,340	4.9
Investment tax credits	(953,360)	(29.3)
Surtax exemption	(19,250)	(.6)
Other	(32,676)	(1.0)
Provision for income taxes	$ 651,000	20.0 %

The sources of deferred income taxes and their effects are as follows:

Tax depreciation in excess of depreciation reported in the financial statements	$ 215,836
Pre-opening center expenses deferred for financial reporting purposes	194,806
Other	(76,642)
Total deferred taxes	$ 334,000

Commitments and Contingencies

The Company leases its center locations and the facility which houses its principal executive offices, warehouse and manufacturing operations under lease agreements which expire at various dates through 2001. The majority of the lease agreements may be renewed, at the option of the Company, for 5 to 10 year terms. These agreements have been accounted for as operating leases. Rent expense under these leases was approximately $2,582,080 in 1981, $693,000 in 1980 and $220,000 in 1979.

Real estate taxes, insurance and maintenance expenses are obligations of the Company.

Minimum future rental commitments under these lease agreements as of December 27, 1981 are as follows:

1982	$ 5,034,885
1983	5,241,591
1984	5,238,510
1985	5,237,062
1986	6,398,843
Thereafter	38,886,995
	$66,037,886

The Company is plaintiff in litigation alleging breach of contract and fraud associated with a Codevelopment Agreement and is currently seeking damages for breach of contract and unfair competition in the approximate amount of $150 million. The defendant brought counterclaims seeking a declaratory judgment and actual damages in excess of $100,000 and punitive damages in excess of $1 million. A non-jury trial on certain issues in the litigation commenced on September 28, 1981. On October 1, 1981, the Court dismissed the defendant's counterclaims and affirmative defenses based on abuse of process, unfair competition and violation of the California Franchise Investment Law. A jury trial on the remaining issues in the case is scheduled to begin in March 1982. Management of the Company, based upon decisions of the Court to date, consultations with counsel and other information currently available, believes the defendant's remaining allegations and counterclaims are without merit and that the outcome of the litigation will not have a material adverse effect on the Company's business or financial condition.

Subsequent Event

Subsequent to year-end the Company agreed to purchase four Pizza Time Theatre centers and related future development rights under territorial development agreements from franchise owners. The aggregate purchase price is approximately $4.7 million.

Auditors' Report

The Board of Directors
Pizza Time Theatre, Inc.:

We have examined the balance sheets of Pizza Time Theatre, Inc. as of December 27, 1981 and December 28, 1980 and the related statements of operations, shareholders' equity and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The financial statements for the year ended December 30, 1979 were examined by other auditors whose report dated February 22, 1980 expressed an unqualified opinion on those statements.

In our opinion, the aforementioned financial statements present fairly the financial position of Pizza Time Theatre, Inc. at December 27, 1981 and December 28, 1980 and the results of its operations and the changes in its financial position for the years then ended in conformity with generally accepted accounting principles consistently applied during the period subsequent to the change, with which we concur, made as of the beginning of fiscal 1980, in the method of recognizing territorial development fee income as described in the notes to the financial statements.

Peat, Marwick, Mitchell & Co.

San Jose, California
February 4, 1982

Common Stock Data

The Company's common stock is traded in the over-the-counter market and is listed on the NASDAQ National List under the symbol CHKY. The price range per common share is the highest and lowest closing bid quotation for Pizza Time Theatre, Inc.'s common stock during each quarter since April 16, 1981, the date the Company's common stock was first sold to the public

Year ended December 27, 1981	[illegible]	[illegible]
Second quarter (from April 16	[illegible]	[illegible]
Third quarter	[illegible]	[illegible]
Fourth quarter	[illegible]	[illegible]

At December 27, 1981, there were approximately 1,259 shareholders of record.

Quarterly Data

Financial Information by Quarter (unaudited)

	Quarter Ended			
1981	March 23, 1981	June 14, 1981	Sept. 6, 1981	Dec. 27, 1981
Total Revenues	$ 5,354,884	$ 7,281,353	$ 9,552,234	$14,030,443
Net income	125,151	358,137	735,329	1,382,439
Net income per common share and common share equivalent	.04	.09	.17	.26
1980	March 24, 1980	June 15, 1980	Sept. 7, 1980	Dec. 28, 1980
Total Revenues	$ 1,672,000	$ 2,216,000	$ 2,702,000	$ 4,835,528
Net income (loss) before cumulative effect of change in accounting method	77,836	(76,494)	20,277	70,260
Cumulative effect of change in accounting method	85,000	—	—	—
Net income (loss)	162,836	(76,494)	20,277	70,260
Net income (loss) per share before cumulative effect of change in accounting method	.03	(.03)	.01	.03
Cumulative effect per share on prior years of change in accounting method	.03	—	—	—
Net income (loss) per share	.06	(.03)	.01	.03
Pro forma net income (loss)	77,836	(76,494)	20,277	70,260
Pro forma net income (loss) per share	$ .03	$ (.03)	$ .01	$ .03

Pro forma amounts assume the current accounting method was applied retroactively.

Revenues and net income during a year may be significantly affected by the timing of the opening of Company Centers and franchised centers and the execution of territorial development agreements. The first three quarters of the Company's fiscal year are of 12 weeks duration, and the fourth quarter is of 16 weeks duration. The Company believes that its business is somewhat seasonal, most centers having slightly lower revenues in the second quarter.

Corporate Directory

Corporate Officers

Nolan K. Bushnell
Chairman of the Board and
Chief Executive Officer

Joseph F. Keenan
President and Chief Operating Officer

John B. Anderson
Vice President, Finance, and Secretary

William J. Koenig
Vice President, Investor Relations,
and Treasurer

John A. Scott
Executive Vice President, Operations

Gene N. Landrum
Senior Vice President, Development

Donald K. Marks
Vice President, Franchising

Jack Campbell
Vice President, Franchise Operations

John A. Impson
Vice President, Cyberamics Products

Patrick J. Saign
Vice President, Marketing

Robert Lundquist
Vice President, Special Projects

Board of Directors

Nolan K. Bushnell
Chairman of the Board
Pizza Time Theatre, Inc.

Joseph F. Keenan
President
Pizza Time Theatre, Inc.

Joseph W. Callahan, Jr.
Principal in CPS Properties
Real estate developers

Wallace R. Hawley
General Partner of InterWest Partners
Venture capital investors

Peter J. Sprague
Chairman of the Board
National Semiconductor Corporation

Donald T. Valentine
President
Capital Management Services, Inc.
Venture capital investors

Annual Meeting

The annual meeting of shareholders will be held Wednesday, April 28 at 10 a.m. at Chuck E. Cheese's Pizza Time Theatre, 2445 Fontaine Road, San Jose, California.

Auditors

Peat, Marwick, Mitchell & Co.,
San Jose, California

Transfer Agents and Registrar

The Bank of California, N.A., San Francisco

Stock Listing

The Company's common stock is traded in the over-the-counter market and is listed on the NASDAQ National List. Symbol: CHKY

Form 10K

If you would like a free copy of our annual report on SEC Form 10K for the fiscal year ended December 27, 1981, please contact William J. Koenig, Vice President – Investor Relations, 1213 Innsbruck Drive, Sunnyvale, California 94086.

Chuck E. Cheese's
Pizza Time Theatre

Corporate Headquarters
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Sunnyvale, California 94086
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PIZZA TIME THEATRE 1981 ANNUAL REPORT

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Version 1.0